2007 LEGISLATIVE PROPOSAL TO ACTUARIALLY FUND THE TEACHERS' RETIREMENT SYSTEM

House Bill 63
Sponsor: Representative John Musgrove

New Legislation for a Strong TRS

Like many other retirement systems, the funding of TRS has not yet recovered from the bear investment markets at the beginning of this decade. As you may remember, a special legislative session was called in 2005 to in part address the issue of a large unfunded liability in the TRS. At that time, the legislature appropriated $100 million from the general fund to help reduce this liability. Unfortunately, although this had a very positive impact on the funding of TRS, it wasn't nearly enough to solve the entire problem.

For the upcoming session, the Montana Teachers' Retirement System Board is supporting new legislation as part of the Governor's budget that includes another infusion from the State general fund, increased contributions paid by the State general fund, and some minor system changes to help keep the unfunded liability from growing unnecessarily.

Additional Contributions from State Needed

The Montana constitution requires all public retirement systems to be actuarially funded. In other words we must be able to forecast (based on reasonable assumptions) that the money coming into the system from contributions and investment earnings will be enough to pay the benefits and expenses we predict will be paid out over the next 30 years. Right now, the data shows we'll have more going out than coming in.

The TRS Board is supporting legislation that would inject another $100 million into the TRS from the State general fund to help reduce this unfunded liability. However, contribution rate increases will be required as well.

The following rate increases are recommended:

- Raise the current employer contribution rate of 7.47% to 9.47% effective July 1, 2007 and to 9.85% effective July 1, 2009. For school districts and community colleges this rate increase will be totally paid by statutory appropriation, thus no increase in property taxes will be required. The bill also includes an appropriation to cover the university and state agency increased costs.
- Increase Montana University System Optional Retirement Program supplemental contributions from 4.04% to 4.72% effective July 1, 2007.

Making Post-Retirement Employment Work for Everyone

Attitudes about working in retirement are changing. Many people are finding that they want or need to continue to work at least part-time once they reach the traditional retirement age. And, as fewer new workers come up behind the baby boomers, employers find they don't want to lose those experienced workers. More and more retirees continue to work at some level.

However, when the TRS System was designed (and funded), it had a more traditional view of retirement and was intended to primarily provide retirement income for those who chose to retire or could no longer work. Based on certain assumptions, the System allows for part-time employment without a reduction in benefits, but only up to certain limits.

The language describing how System benefits are affected for those who work in retirement is not clear enough. As retirees and employers attempt to navigate this new territory, they find the current provisions don't provide much guidance. Currently, there are loopholes that allow some retirees to continue to receive their full TRS benefit while working essentially full time or while receiving a total compensation package that's significantly higher than the maximum of one third of pre-retirement pay allowed under the System. These are employees that under a plain understanding of the intent of the System would be considered active employees – employees for whom employer and employee contributions into TRS would normally be made. Instead, not only are they not paying into the system – they're receiving full benefits. In the end, this means higher liabilities for the System than necessary.

While within the letter of the law, these arrangements are pushing the limits of what the System was designed to handle. As more people take advantage of this loophole, the system is left with the task of coming up with additional funding. If everyone took advantage of these loopholes, the employer contribution rate would need to be increased significantly. Clarifying these provisions will allow everyone equal access to benefits and provide consistency between intent and practice.

The legislation proposes:

- **Clarifying part-time and full-time employment —** Currently, the System simply defines full-time employment as "service that is full time and extends over a normal academic year of at least 9 months." Part-time service is defined as "service that is less than full time." That leaves a significant grey area for those who want to continue to work in retirement. This legislation would clearly define full-time service as 180 days a year or 140 hours per month and part-time service as less than 180 days a year or 140 hours a month.
- **Defining compensation, not just pay —** Because of the way the System defines post-retirement income, some retirees are able to continue to receive their full retirement benefit while earning more than the maximum $^{1}/_{3}$ of their final pre-retirement compensation allowed under the System. They receive additional compensation in the form of employer-paid benefits. This legislation would include all remuneration paid to retired members including benefits such as allowances for cars and housing, professional membership dues, annuities and reimbursement of nonwork-related expenses.

Eliminating Unrealistic Statutory Requirements

Allowing Interest Credits to Mirror Investment Earnings

The Board sets the amount of the interest that is credited to employee contributions each year but cannot credit interest of less than 4%. Unfortunately, the system hasn't necessarily earned 4% or more on its investments over the last several years. One factor contributing to the System's funding issues is crediting 4% when the system is earning less than that, or even losing money. Allowing the Board to set a prudent interest rate related to market return is more realistic.

Remove GABA Increase Requirement

The Guaranteed Annual Benefit Adjustment is currently set at 1.5%. However, the System includes a provision that allows the Board to increase the GABA to 3% whenever the amortization falls below 25 years. Given the current underfunded situation, and the near impossibility the legislature will appropriate funds for additional benefits anytime soon, removing this requirement until a time when it's more likely to materialize would offer more realistic expectations for our retirees.

Changes That Add up to a Healthy Future

None of the changes the Board is recommending can solve the Retirement System's funding dilemma by themselves. Taken together, however, they move the TRS forward in meeting our constitutional obligation to fully fund the System. The impacts are spread among the State, employers and retirees. This is a difficult challenge, but it is one we can solve together.